

Investments and Pensions Oversight Committee

September 9, 2014

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NEW MEXICO
RETIREE
HEALTH CARE
AUTHORITY

NMRHCA Investment Holdings

- NMRHCA is required by statute to invest trust fund through the State Investment Council (SIC)
- SIC provides access to six qualified investment “pools”
 - US Large Cap Active
 - US Large Cap Index
 - US Small Cap Index
 - Non-US Developed Markets Index Pool
 - Non-US Emerging Markets Active Pool
 - US Core Bonds
- SIC selects fund managers within each “pool”

NMRHCA Investment Holdings

PORTFOLIO ALLOCATION FOR THE MONTH ENDED JULY 31, 2014

Investment	Market Value	% of Total	Long-term Target	Policy Range
Equity				
Domestic				
Large Cap Active	\$ 55,570,526.49	15%	12.5%	20-30%
Large Cap Index	55,396,617.09	15%	12.5%	
Mid/Small Cap	42,912,875.13	11%	10%	5-15%
		41%	35%	
International				
Non US Developed	57,378,600.99	16%	15%	10-20%
Emerging Markets	43,717,282.09	11%	15%	10-20%
		27%	30%	
Fixed Income				
Core Bonds	121,882,196.75	32%	35%	30-40%
		32%	35%	
Total	\$ 376,858,098.54	100%	100%	

Investment Strategies

General Objectives

- Primary objective of the fund is to generate a total return in excess of the assumed actuarial return as determined annually by the Board including: realized and unrealized gains, plus income, less expenses with a prudent level of risk. Current actuarial assumption is 7.75%.
- Provide liquidity to meet all cash needs and serve as a buffer against higher than anticipated adverse claims. As such, the fund maintains a position in highly liquid market instruments.
- Provide diversification to avoid significant losses and preserve capital, while operating under the Prudent Investor Rule.

Execution

- Operate within parameters of Joint Powers Agreement (JPA) with SIC.
- Utilize investment consultant to annually review and make recommendations for asset allocation. Current agreement is with NEPC (also does work for ERB).
- Asset allocation modeling identifies asset classes the fund will use and target percentage and appropriate ranges that each class will represent in the total fund with rebalancing to occur when assets fall outside of range.

Asset Allocation

- Large Cap US Equity – 25% (Range: 20% - 30%)
- Small/Mid Cap US Equity – 10% (Range: 5% - 15%)
- Non-US Developed Markets – 15% (Range: 10% to 20%)
- Non-US Emerging Markets – 15% (Range 10% to 20%)
- US Core Bonds – 35% (Range: 30% to 40%)

Asset Allocation Review

- NEPC presented an Asset Allocation Review at the July 2014 Board Meeting. Current asset allocation “optimal” based on access to current pools
- SIC voted to include alternative asset classes in offerings to NMRHCA (and other third party clients) in 2014
- NEPC Comments:
 - “The fund’s current asset allocation has 67% in equities, which contributes 95% of the fund’s total risk”
 - “Diversification through investment into SIC pools Real Estate, Private Equity, Credit and Structured and Absolute Return can result in opportunities to enhance the risk/return profile”
- Reviewing current JPA to facilitate most recent recommendations with the following key elements for consideration associated with alternative investments:
 - Lock Up Period – A period during which clients may not redeem their holdings
 - Notice Period – A period of time in which the fund manager has notice of redemption to delivery of cash
 - Liquidity Window – Limits on how often a client can request liquidity

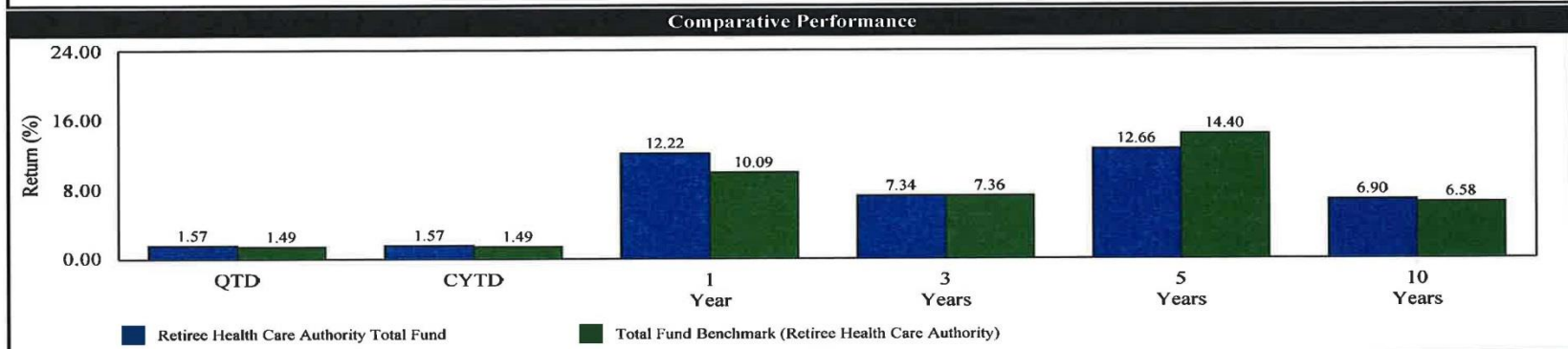
Management Fees

- NMRHCA pays no fees for services rendered by SIC
- NMRHCA pays fees incurred from external fund managers on a pass through basis based on the percentage of NMRHCA assets within that fund
- Fees are paid quarterly
- FY2014 Total Fees - \$853K on assets of \$376 million
- Approximately 22 basis points in management fees
- SIC's \$19 billion portfolio allows NMRHCA to pay lower rates than it otherwise would on the open market

Investment Returns

**New Mexico State Investment Council
Retiree Health Care Authority
As of March 31, 2014**

Asset Allocation vs. Target Allocation			
	Market Value (\$)	Allocation (%)	Target (%)
Large Cap US Equity	104,103,849	29.42	25.00
Small/Mid Cap US Equity	43,534,382	12.30	10.00
Non-US Developed Markets	38,158,741	10.78	15.00
Non-US Emerging Markets	54,133,025	15.30	15.00
US Core Bonds	113,977,863	32.21	35.00
Total Fund	353,907,860	100.00	100.00



Comparative Performance									
	QTD	CYTD	1 Year	3 Years	5 Years	10 Years	2013	2012	2011
Retiree Health Care Authority Total Fund	1.57	1.57	12.22	7.34	12.66	6.90	15.64	13.66	-3.74
<i>Total Fund Benchmark (Retiree Health Care Authority)</i>	1.49	1.49	10.09	7.36	14.40	6.58	13.29	12.90	-0.87

Allocations shown may not sum up to 100% exactly due to rounding. Performance shown is gross of fees.

Solvency Update

2007 Status

- Projected Solvency 2014
- \$122.8 million Trust Fund Balance
- \$4.1 billion unfunded liability (3% funded)
- FY07 - \$5.7 million withdrawn from Trust Fund

2014 Status

- Projected Solvency 2033
- Trust Fund Balance: \$376.9 million (July 2014)
- \$3.6 Billion Unfunded Liability (11% funded)
- FY14 –\$57.5 million transferred to Trust Fund

Results

- 7 year solvency period compared to 19 year solvency period
- \$254.1 million increase in Trust Fund Balance
- \$500 million reduction in Unfunded Liabilities

Board Action for 2015

I. Plan Rates & Pre-Medicare Spousal Subsidies

Plan Rates: Increase all pre-Medicare rates by 8% and Medicare Supplement Rates by 5%

- NMRHCA long-term solvency projections include annual 8% rate increases as part of its baseline assumptions in order to keep pace with rising medical costs. Changes to this rate or increase in any given year are based on a valuation of NMRHCA's overall loss ratio (how closely NMRHCA rates match actual costs).
- NMRHCA's loss ratio has improved but remains steady at 102% - 103%. There is improvement on the Medicare Supplement plan mainly due to increased federal prescription subsidies as a result of federal health care reform but also significant adverse selection pressure on the pre-Medicare plans.

Reduce Pre-Medicare Spousal Subsidy by 2% (from 40% to 38%)

- NMRHCA's five year strategic plan includes a provision to reduce the subsidies for pre-Medicare spouses. This will be the first phase of that process. Additional changes/reductions will be viewed in subsequent years based on changing market environments resulting from federal health care reform as well as overall plan performance.

Cumulative Rate Impact

	Number of Members	2014 Monthly Rate	2015 Monthly Rate	Difference
Premier Plus Retiree	4,380	\$ 272.03	\$ 293.79	\$ 21.76
Premier Retiree	6,976	\$ 145.55	\$ 157.19	\$ 11.64
Premier Plus Spouse	1,249	\$ 421.16	\$ 463.28	\$ 42.12
Premier Spouse	2,833	\$ 270.26	\$ 297.29	\$ 27.03
Premier Plus Couple		\$ 693.19	\$ 757.07	\$ 63.88
Premier Couple		\$ 415.81	\$ 454.48	\$ 38.67
Medicare Supplement Retiree	16,798	\$ 159.89	\$ 167.88	\$ 7.99
Medicare Supplement Spouse	5,576	\$ 239.83	\$ 254.22	\$ 14.39
Medicare Supplement Couple		\$ 399.72	\$ 419.71	\$ 19.99

Board Action for 2015

II. Minimum Age Requirement

Institute minimum age of 55 in order to receive subsidies through NMRHCA for all new retirees after January 1, 2020 (exception: PERA enhanced plans)

- NMRHCA's five year strategic plan includes the introduction of a minimum age to receive subsidies from NMRHCA. While a graduated reduction of subsidies based on age has been discussed in the past, elements of federal health care reform as they relate to the exchange make a distinct cut off point more advantageous.
- NMRHCA currently has 643 individuals retired under the age of 55 (average age of retirement 59); approximately half of which belong to enhanced PERA plans such as law enforcement and firefighters and would not be impacted by any minimum age requirements as these plans pay 25% more into NMRHCA in the years they contribute.
 - Additional Annual Revenue: $160 \text{ individuals} \times \$41,833 \text{ (avg salary)} = \$6.7 \text{ million} \times 3\% \text{ NMRHCA contribution} = \$200,00$
 - Reduced Annual Expenses: $320 \text{ individuals} \times \$5,570 \text{ (avg annual cost for age band)} \times 65\% \text{ NMRHCA portion} = \1.1 million
 - Total Savings: \$1.3 million per year (recurring and indexed with medical cost trend)

Board Action for 2015

III. Years of Service

Increase years of service required for maximum subsidy from 20 to 25 for new retirees after January 1, 2020 (exception PERA enhanced plans)

- Illustrative Premium Differentials Based on 2014 Premiums for Premier Plan

	Rates at Curent Subsidy Levels		Rates at Proposed Subsidy Levels		
	NMRHCA	Retiree	NMRHCA	Retiree	Difference
5 Years of Service	\$ 16.89	\$ 398.97	\$ 12.87	\$ 402.99	\$ 4.02
10 Years of Service	\$ 101.37	\$ 314.49	\$ 77.23	\$ 338.63	\$ 24.14
15 Years of Service	\$ 184.84	\$ 230.02	\$ 141.59	\$ 274.23	\$ 44.21
20 Years of Service	\$ 270.31	\$ 145.55	\$ 205.95	\$ 209.91	\$ 64.36
25 Years of Service	\$ 270.31	\$ 145.55	\$ 270.31	\$ 145.55	\$ -

- Average Premium Differential Per Affected Retiree: \$32 per month
- Projected number of Affected Retirees: Approximately 200 per year
 - 1st year savings: \$100 thousand
 - 5 year savings: \$2 million
 - 10 year savings: \$7 million
 - 20 year savings: \$46 million

Impact on GASB: \$100 million reduction in Actuarial Accrued Liabilities

Age and Years of Service Adjustments will require a change to NMRHCA Rules

Board Action for 2015

IV. Strategic Plan Addition

Addition to 5-year Strategic Plan: Convert \$6,000 basic life insurance to supplemental life insurance and phase out subsidy beginning in 2017

- Existing agreement between NMRHCA and The Standard for term life insurance expires on June 30, 2015
- Fall 2014 - RFP will be issued for term life insurance to be collectively purchased between GSD, NMPSIA and APS
- RFP will request a quote for the conversion of the existing basic life policies into supplemental policies which will be 100 percent subsidized or paid in full by NMRHCA the first year (2016); 75 percent the second year (2017); 50 percent the third year (2018); 25 percent paid in the fourth year (2019); and 0 percent paid in the fifth year (2020)
- Projected savings: \$81.6 million over 22 years
 - Total Members Impacted: 29,244
 - Average Impact Per Retiree: Approximately \$12 per month when fully implemented
 - Impact on Solvency: 1 Year

2015 Legislative Proposal

Proposed Legislation:

- Increase employee contributions from current level of 1 percent to 1.375 percent over a 3 year period beginning FY17
- Increase employer contributions from the current level of 2 percent to 2.75 percent over a 3 year period beginning in FY17
- No impact to FY16 proposed expenditures
- 2014 Legislative Proposal Reduced by Half
- Employee/Employer contributions levels, estimated General Fund impact, and NMRHCA revenue shown below:

2015 Legislative Proposal							
A	B	C	D	E	F	G	H
Fiscal Year	Employee	Increase	Employer	Increase	GF Impact	Total	RHCA Revenue
FY16	1.00%	NA	2.000%	NA	NA	NA	NA
FY17	1.125%	0.125%	2.250%	0.250%	\$5,000,000	3.375%	\$15,000,000
FY18	1.250%	0.125%	2.500%	0.250%	\$5,000,000	3.750%	\$30,000,000
FY19	1.375%	0.125%	2.750%	0.250%	\$5,000,000	4.125%	\$45,000,000

Contributions for public safety employees and employers will retain 1.25 : 1.00 ratio to account for fewer years worked and exemption from minimum age and years of service changes

Resulting Impact

NMRHCA

- Solvency period extended through 2040
- 25-year solvency as recommended by the 2007 HB728 Work Group

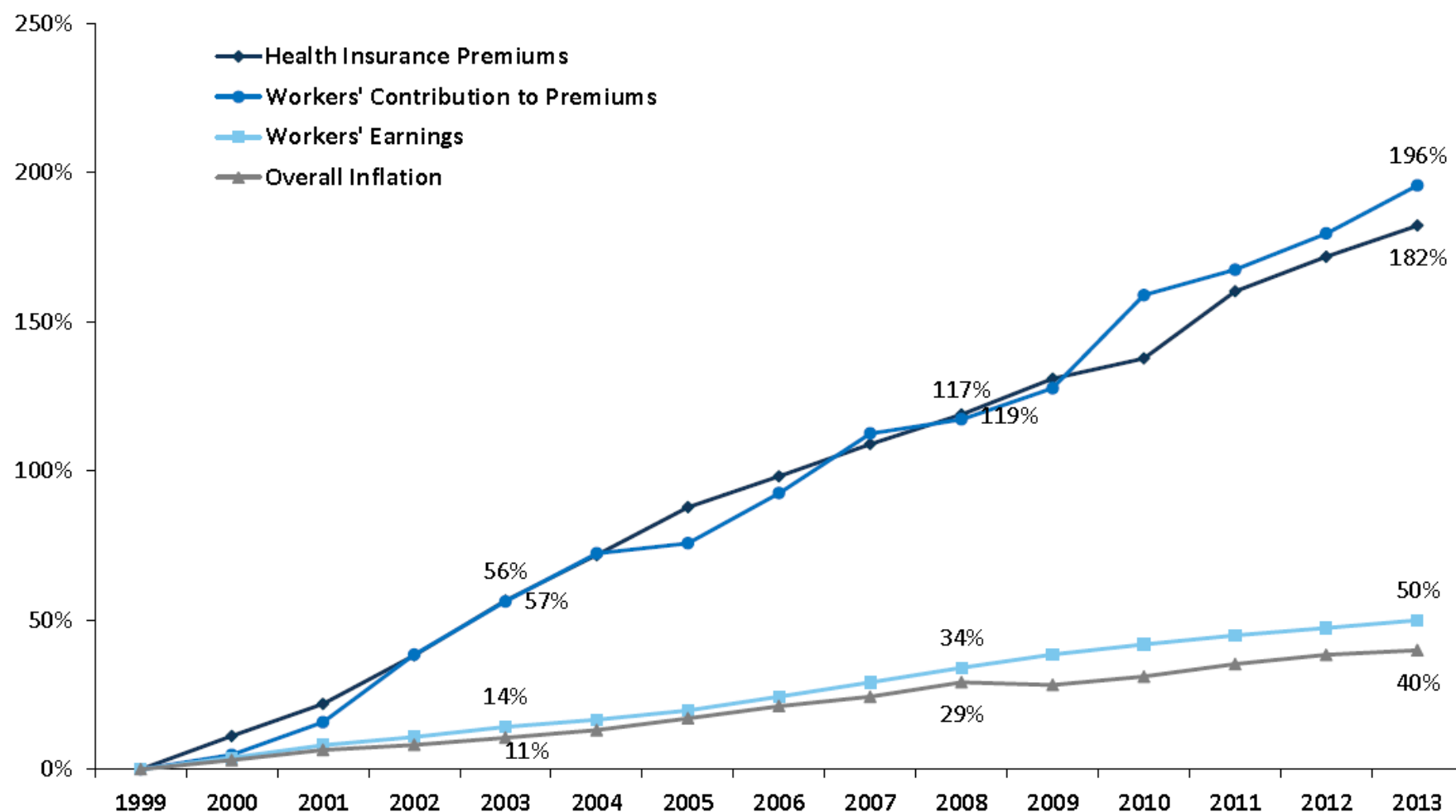
Employee Impact

- An employee earning \$40,000 annually currently pays \$15.39 per pay period (1%) which will increase to \$21.15 (1.375%) over a 3 year period. Net take-home pay will be reduced each pay period by \$1.92 the first year of the increase (FY17); \$3.84 the second year (FY18) and \$5.76 the third year (FY19).

Employer Impact

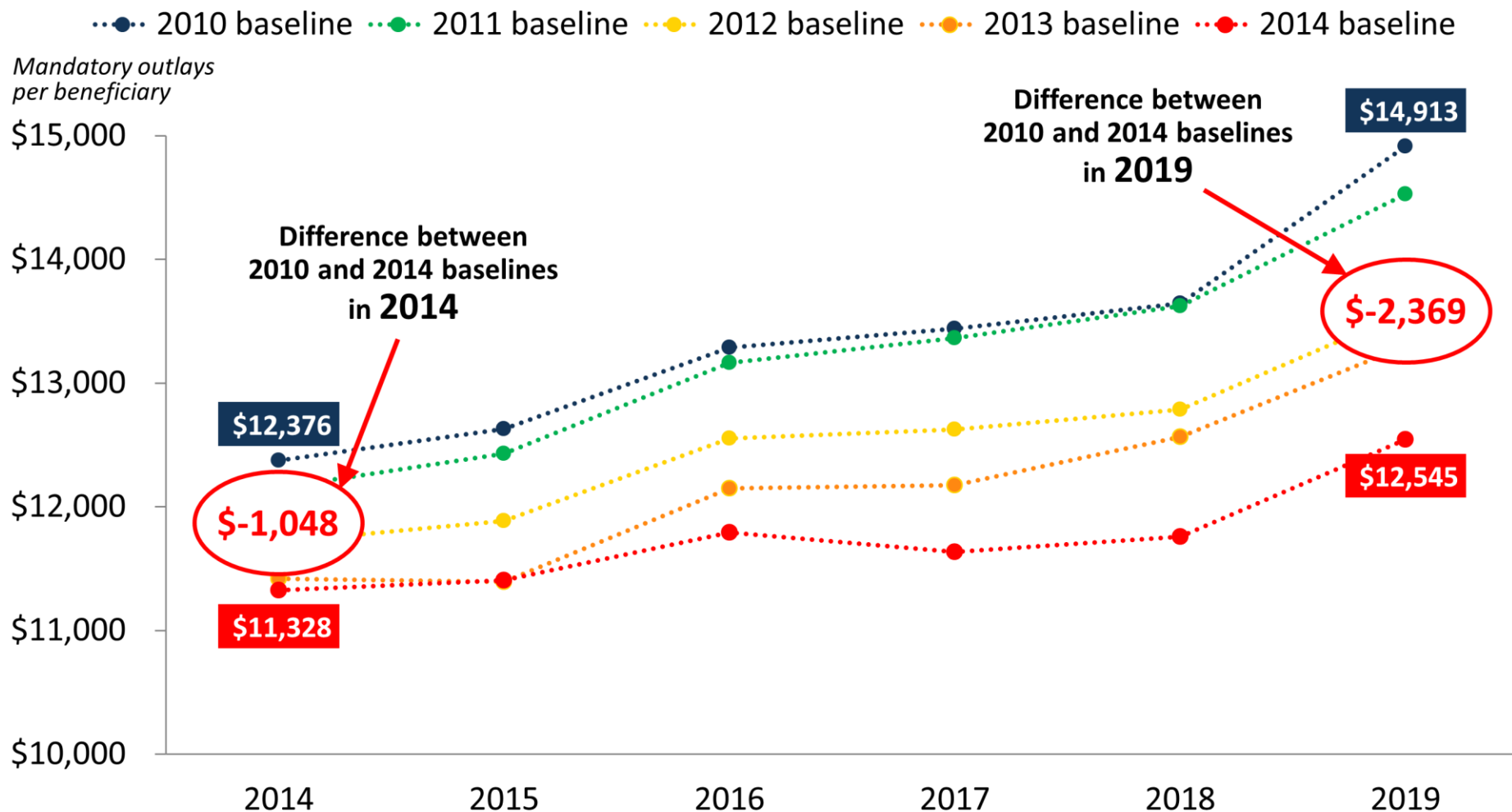
- An employer (for each \$40,000 employee) currently pays \$30.77 (2%) per pay period
- Each .25% increase will result in \$3.84 increase in contribution
- A .75% increase will result in an increased contribution of \$300 annually
- Each .25% increase in employer contribution will have an approximate \$5 million general fund impact

Cumulative Increases in Health Insurance Premiums, Workers' Contributions to Premiums, Inflation, and Workers' Earnings, 1999-2013



SOURCE: Kaiser/HRET Survey of Employer-Sponsored Health Benefits, 1999-2013. Bureau of Labor Statistics, Consumer Price Index, U.S. City Average of Annual Inflation (April to April), 1999-2013; Bureau of Labor Statistics, Seasonally Adjusted Data from the Current Employment Statistics Survey, 1999-2013 (April to April).

Medicare spending is expected to be \$1,000 lower per beneficiary in 2014 than was projected in 2010, and \$2,400 lower in 2019



SOURCE: Kaiser Family Foundation analysis of mandatory Medicare outlays and Medicare enrollment data from CBO Medicare baseline projections, 2010-2014.